NEWFOUNDLAND
AND LABRADOR
HYDRO

ANNUAL REPORT 1986

NEWFOUNDLAND AND LABRADOR HYDRO GROUP OF COMPANIES

CORPORATE MISSION STATEMENT

The mission of the Newfoundland and Labrador Hydro Group of Companies is to provide electrical power and energy, on behalf of the people of the Province, at the lowest cost consistent with reliable service, due consideration for the environment and the safety of our employees and the customers which we serve.

Hydro is planning, building and operating electrical generation, transmission and distribution facilities to fulfill this aim. All activities are performed under the overriding requirement that they be consistent with the financial, energy and development policies of the Government.

The Newfoundland and Labrador Hydro Group of Companies is committed to the maintenance of a corporate organization and managerial structure which operates effectively and efficiently and earns recognition for corporate leadership, productivity, financial responsibility and integrity.

Each of our employees contributes to achieving our mission. We seek to attract, retain and promote high quality employees in order to ensure maximum productivity and efficiency, by rewarding performance through competitive compensation and benefit programs, comprehensive management training and nondiscriminatory opportunities for career development.

TABLE OF CONTENTS

Message from the Chairman and Chief Executive Officer 2

Review of Operations, Engineering and Construction 4

Human Resources 9

Hydro in the Community 12

Rates and Finance 13

Review of Churchill Falls Operation 14

Financial Review 16

Management Report 21

Consolidated Financial Statements 22

Seven year summary of Operating Statistics 29

Seven year summary of Financial Statistics 30

Directors and Officers 31

Cyril J. Abery

MESSAGE FROM THE CHAIRMAN AND CHIEF EXECUTIVE OFFICER

The Hydro Group of Companies is an important element in the economy of Newfoundland and Labrador and is dedicated to the development, generation, transmission and sale of electricity both for consumption within the Province as well as for export. It is one of the largest industrial enterprises in the Province and in terms of capacity and assets is one of the largest electric utilities in Canada. The parent company of the Group, Newfoundland and Labrador Hydro, is wholly owned by the Province and is the corporate vehicle through which the Province implements its policies with respect to electrical energy.

Hydro's "corporate mission statement" is displayed at the beginning of this Report to highlight the reasons for the Corporation's existence, its commitment to its mission and to its employees and customers.

A major change in Hydro's pricing of electricity took place during the year with the replacement of the fuel adjustment charge, previously included as a supplement on our customers' bills, with a single fixed rate. This new pricing arrangement operates in tandem with a rate stabilization plan. The new plan was in effect for the entire year and resulted in stable prices for electricity as the vagaries of weather and fuel prices were absorbed by the plan for a future adjustment in rates.

In contrast with recent years there was no major generation project under construction. However, planning continued with respect to our next generation source and the timing of its construction to meet anticipated load growth during the next several years. Plans were also formulated and decisions made to extend the benefits of electricity produced on the Island grid to several communities not previously interconnected, thereby removing more customers from dependency on high cost diesel generated electricity.

During the year a Management Seminar was convened, at which a large number of managers representing the member companies of the Hydro Group met, to reflect on our "purpose" and to consider our future corporate goals and how we might achieve them. The results of this seminar will serve as a reference for our future plans.

Hydro's success depends to a large extent on the dedication and professionalism of its employees. It also depends on acceptable financial results because a sound financial position is essential if we are to attract the capital needed to build future projects. Hydro, as a regulated utility, is required to achieve a margin of profit within a predetermined and approved range.

In 1986 Hydro once again was successful in achieving this objective, thereby continuing the steady improvement in its financial position. The improving financial position of the Group reflects a determination to comply with The Electrical Power Control Act which requires Hydro "to recover the cost of service provided by it and a margin of profit sufficient to achieve and maintain a sound financial position so it is able to achieve and maintain a sound credit rating in the financial markets of the world".

The nature of the electric utility business is such that we are required to anticipate the major challenges which inevitably lie ahead. We must anticipate and plan for load growth and decide how it is to be satisfied; we must consider our relationship with our customers and be sensitive to their energy needs; and we must communicate with our employees and be aware of their need to keep abreast of advancing technology through training. In short, we cannot afford to become complacent and be content with the status quo. Hydro has had and will continue to have a significant role to play in the development of the Province. The challenges we face are formidable, but we must meet them eagerly.

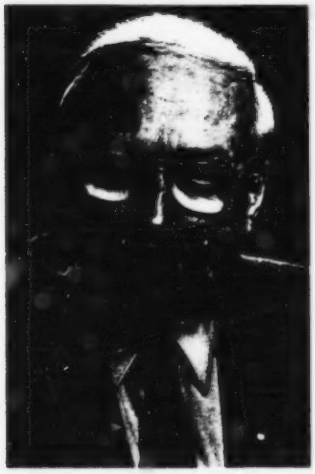
I encourage the reader to review the remainder of this report as it highlights our 1986 achievements from several perspectives. I also extend to all employees my sincere expression of thanks and congratulations for a successful year which has added to Hydro's strengths.

Cyril J. Abery

CYRIL J. ABERY
Chairman & Chief Executive Officer

BOARD OF DIRECTORS

Janet C. Gardiner



Lawrence D. Fahey

Edward M. Hearn

Moses O. Morgan

David W. Mercer, Ex-officio

Roland T. Martin

Cyril J. Abery
Chairman and Chief Executive Officer
Newfoundland and Labrador Hydro
St. John's

Janet C. Gardiner
Treasurer
Chester Dawe Limited
St. John's

Lawrence D. Fahey
President
Fahey Building Limited
St. John's

Edward M. Hearn
Barrister and Solicitor
Miller & Hearn
Labrador City

Dr. Moses O. Morgan
President Emeritus
Memorial University of Newfoundland
St. John's

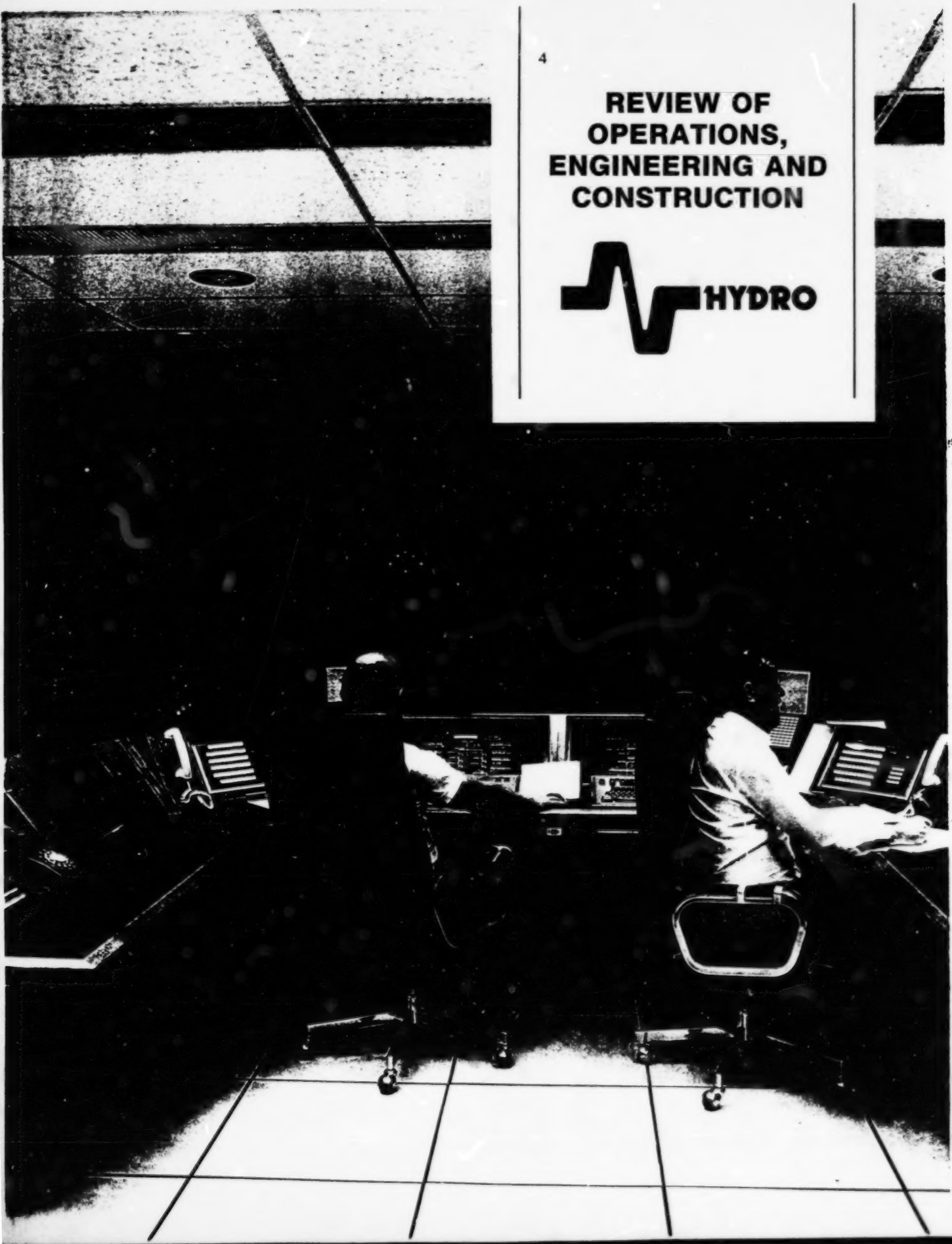
David W. Mercer
President
Newfoundland and Labrador Hydro
St. John's

Roland T. Martin
President and Chief Operating Officer
Keltic Incorporated
Halifax, Nova Scotia

4

REVIEW OF OPERATIONS, ENGINEERING AND CONSTRUCTION

HYDRO



ENERGY SALES TO HYDRO CUSTOMERS

1986 energy sales to Island customers equalled the record sales established in 1985. Total energy sales for 1986 were 5,042 million kilowatthours. Our utility customers, of which Newfoundland Light & Power Co. Limited is by far the larger, purchased 3,440 million kilowatthours (68%), with the remaining 1,602 million kilowatthours being sold to our industrial customers. Slightly reduced energy sales to this latter group of customers, compared to 1985, offset a modest increase in sales to our utility customers, resulting in overall sales similar to those of 1985.

Energy sales to customers in Labrador continued to increase at significant growth rates and reached a new record of 606 million kilowatthours, a 34% increase over 1985. This increase is due primarily to the increased energy requirements of the Iron Ore Company of Canada in Labrador City and increased sales in the towns of Wabush and Happy Valley-Goose Bay.

ENERGY PRODUCTION FOR HYDRO'S CUSTOMERS

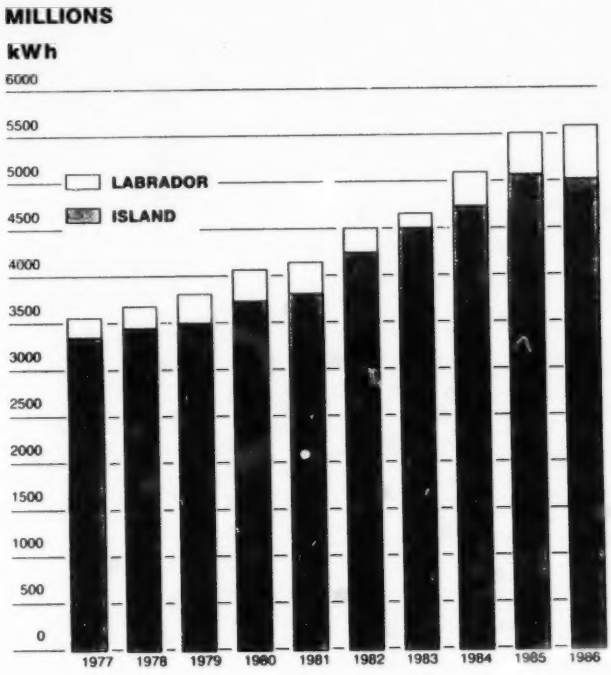
Energy production from Hydro's generating facilities on the Island of Newfoundland totalled 5,234 million kilowatthours during 1986, compared to 5,282 million kilowatthours during 1985. In addition to this, 61 million kilowatthours were purchased, primarily from Deer Lake Power Company, for a total electrical energy supply of 5,295 million kilowatthours.

Seventy-four percent (74%) of this total supply figure, or 3,908 million kilowatthours, was produced from four hydroelectric generating stations: 2,396 million kilowatthours were generated at Bay D'Espoir, 265 million kilowatthours at Hinds Lake, 505 million kilowatthours at Upper Salmon and 742 million kilowatthours at Cat Arm. This hydroelectric production is approximately 13% higher than 1985 due primarily to the addition of our newest hydroelectric generating station at Cat Arm.

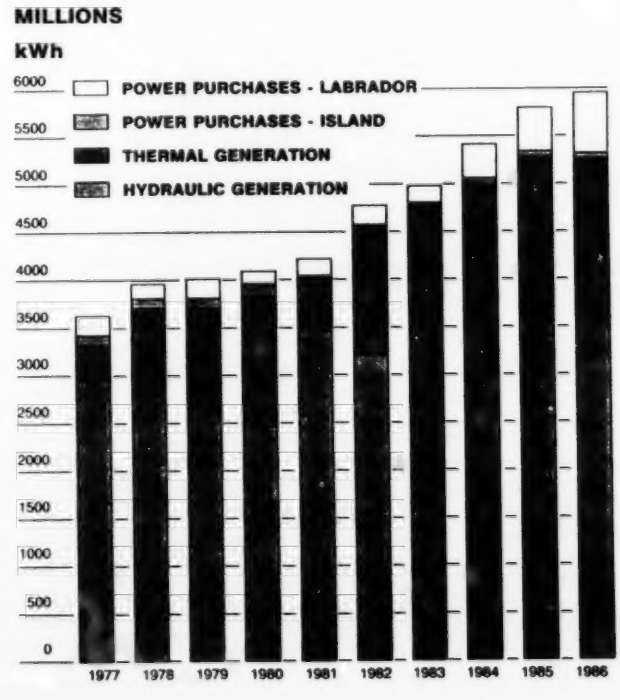
We continued to experience extremely low water inflows into our reservoirs for the second consecutive year, requiring reliance on generation from our oil-fired thermal generating station at Holyrood. Two million barrels of oil were burned in 1986 at Holyrood for production of 1,324 million kilowatthours, or 25% of our total energy supply.

The system peak for the year, 1,084,000 kilowatts, occurred on March 10, 1986. This is the highest peak load ever recorded on Hydro's system.

ENERGY SALES HYDRO OPERATIONS



SYSTEM GENERATION AND ENERGY PURCHASES HYDRO OPERATIONS



ENERGY SUPPLY TO RURAL CUSTOMERS

Hydro provides operational services to the Power Distribution District of Newfoundland and Labrador ("PDD") which is responsible for the Rural Electrification Program within the Province. PDD serves 75,000 people (27,000 customers) in approximately 200 rural communities, either by (i) purchasing power from the main power grid and distributing it to its interconnected customers, or (ii) supplying electricity directly to its customers from local diesel generators. Revenue from PDD customers is not sufficient to meet its high operating costs. The Provincial Government provides an annual subsidy to PDD, in the order of $23 million, to make up the shortfall.

Sales by PDD to its approximately 17,000 Island and Labrador interconnected customers in 1986 were 333.4 million kilowatthours, an increase of 8.1% over the 1985 level. All of this growth occurred on the Labrador interconnected system, notably in Wabush and Happy Valley-Goose Bay. Sales to the remaining 10,000 customers on PDD's isolated diesel systems, both on the Island and in Labrador, were 91.6 million kilowatthours, an increase of 7.5% over 1985.

During 1986 PDD purchased 77% of its energy requirements from Hydro and the remaining 23% was produced primarily from diesel generation.

Continued excellent results are being achieved from the fuel efficiency program initiated in 1984 and now extended to all of PDD's thirty-seven diesel generating stations.

PDD capital expenditures for 1986 were $6.3 million, of which $1.5 million was spent on generating facilities and $4.8 million on upgrading and extending the distribution systems to meet the increasing power demands of customers. On April 17, 1986, the community of Pinsent's Arm on the Southern Coast of Labrador received electrical power for the first time. Electricity is now supplied to the fifteen customers in this community from the diesel generation station at Charlottetown, approximately 20 km to the north.

During the latter part of 1986 PDD received approval to construct a diesel generating station and distribution system in the community of Norman Bay, also on the Southern Coast of Labrador. When this project is completed in mid-1987, all communities in Newfoundland and Labrador with more than fifteen permanent residents will be served with electricity.

ENERGY PLANNING, ENGINEERING AND CONSTRUCTION FOR HYDRO'S CUSTOMERS

Current energy supply and demand forecasts indicate that the Island will require a new base load source of electrical energy by the 1990-1991 time period. In late 1986, the System Planning Department initiated a major series of generation expansion studies to identify the most appropriate generation plan that Hydro should pursue prior to our anticipated interconnection with hydroelectric facilities in Labrador. A decision on additional generation is expected to be made in early 1987.

Hydro continued its interest in "alternative energy programs" and in 1986 issued a policy for the purchase of energy from private developers. Wind monitoring studies were conducted during the year, in cooperation with the Provincial Department of Mines and Energy and the Federal Department of Energy, Mines and Resources, at two wind monitoring sites located in the St. Anthony area. Hydro also completed an inventory study of approximately 200 potential small hydroelectric sites located on the Island of Newfoundland. This study revealed that approximately 160 of these sites have promise for development and further screening will be done during 1987 to identify the most technically and economically attractive sites.

Hydro decided in 1986 to proceed with the design and acquisition of a new Energy Management System to be available for service by the third quarter of 1990. This system will become the nerve center of the Corporation's Island-wide operations and will enable direct control of all the Corporation's generating plants and the Provincial transmission grid. This will permit more efficient operation of the Corporation's facilities and more effective control of electrical energy production.

No major generating facility was under construction in 1986. Hydro's $21 million of capital expenditures were associated solely with transmission, terminal and other

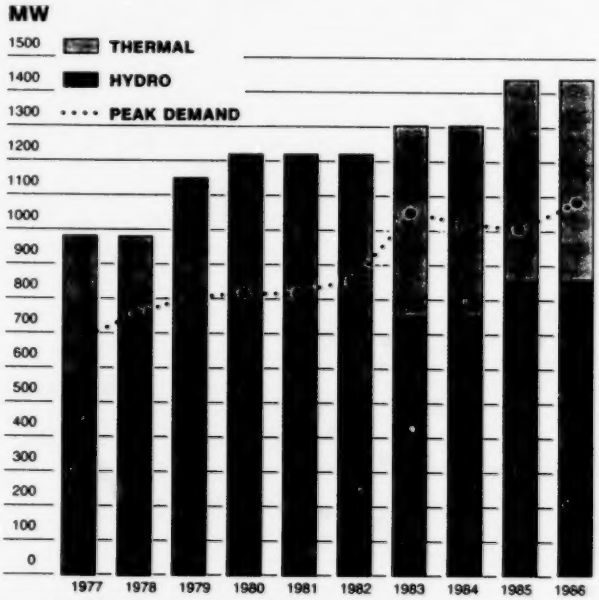
facilities. A notable element in this program was the commencement of construction of a $25 million 138 kV transmission line to supply electrical power and energy to the Hope Brook gold mine which is located on the southern coast of the Island of Newfoundland. Associated construction activity will provide for extension of the Island grid to the nearby communities of Burgeo and Grand Bruit. This interconnection will permit PDD to charge lower electricity rates to approximately 800 customers in these communities which are currently being served by high cost diesel generation.

During 1986 preliminary engineering studies were completed for the potential Island Pond and Paradise River hydroelectric sites and cost estimates developed for further water diversions into the Hinds Lake reservoir. In addition, a complete rebuild of the Holyrood 10 MW gas turbine, together with the redesigning of its control circuitry, was undertaken and completed at the cost of $2.6 million.

Engineering design was intitiated on a 25 kV submarine cable interconnection to Fogo and Change Islands. Construction of this $14 million facility to interconnect these Islands with the Provincial transmission grid will commence during 1987 and is scheduled for completion in late 1988. This submarine link will displace the existing diesel generating systems on Fogo and Change Islands and result in lower electrical rates for approximately 1600 customers.

Final engineering studies respecting the feasibility of constructing a wood chip generating facility in the Roddickton area commenced during the latter part of the year and are scheduled for completion in March of 1987. Preliminary results indicate that the project is technically viable.

GENERATING CAPACITY AND DEMAND HYDRO OPERATIONS



NOTE: EXCLUDES DEMAND IN LABRDOR SUPPLIED BY PURCHASED POWER

HUMAN RESOURCES

Undoubtedly the ultimate success of an organization depends to a significant degree upon the quality of its employees. The Hydro Group continues to be fortunate in that it has been able to attract and retain staff with a very high level of dedication and expertise. The Hydro Group employs approximately 1250 full time employees and, at varying times throughout each year, retains several hundred additional staff to meet the demands of the peak work season with respect to the maintenance of its system.

During 1986 an affirmative action program for women was initiated and is being actively supported by the Corporation. The program is designed to ensure that women achieve the goal of equal employment opportunity.

Collective agreements were signed in 1986 with The International Brotherhood of Electrical Workers for employees in the Office Workers Unit and the Operations Unit of Hydro for terms ending March 31, 1988 and March 31, 1989 respectively. Temporary employees not previously covered by collective agreements were included in the bargaining units by the Province's Labour Relations Board and are now covered by the existing labour agreements.

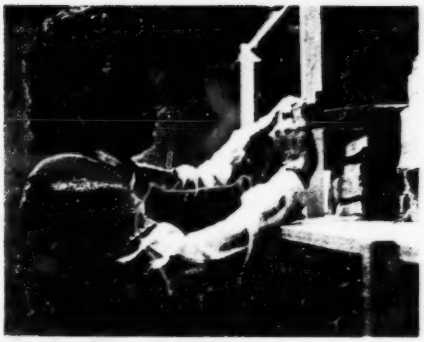
The Loss Control Program, initiated within the Hydro Group during 1985, constituted a significant part of training activity during the year. The program chosen by Hydro was developed in North America from an internationally agreed set of standards and it has gained wide recognition. This structured program is being actively promoted within the Hydro Group with the express purpose of controlling losses by identifying factors which could result in personal injury or property damage.

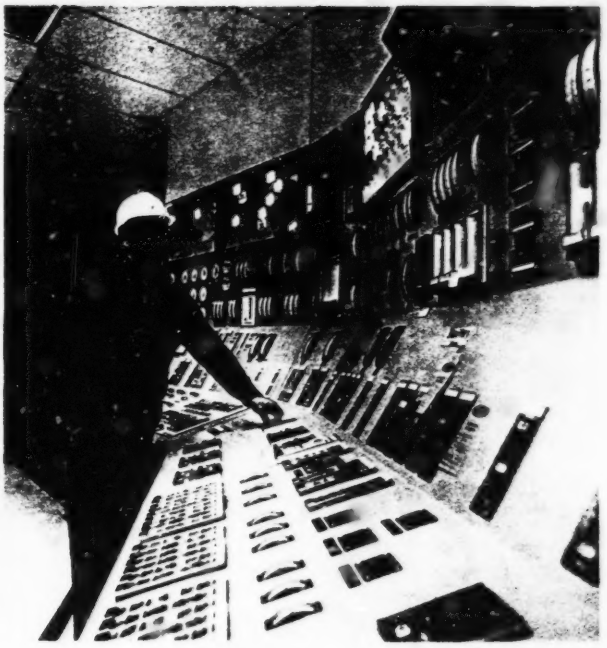
A twenty week data processing training program was begun in September with completion scheduled for early in the New Year. The program was offered to employees who were selected following a company wide competition and was designed to train them in computer technology using both internal and external computer and data processing training personnel. The knowledge gained by the participants in the program

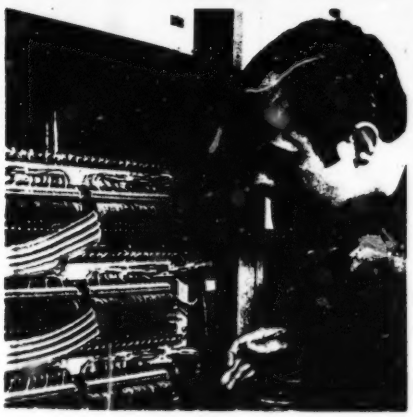
will be used during the implementation of new computer systems and will greatly improve the effectiveness of our employees as the application of computer technology becomes more and more commonplace.

Other aspects of training included supervisory development and safety programs. During the year there were approximately 200 separate classroom sessions regarding technical, managerial and safety training.

Accident prevention is a high priority objective of the Hydro Group and efforts intensified during the year with respect to promoting awareness of accident prevention. Only 4000 employee hours, out of a total of 2.2 million employee hours, were lost due to accidents during the year. For the second consecutive year Hydro received the Safety Achievement Award of the Canadian Electrical Association presented in recognition of a twenty-five percent or greater improvement in its annual accident frequency statistics. There were nearly 500 safety meetings throughout the system during the year. As an extension of this program, special assistance was provided to the school safety program as well as to various local safety oriented volunteer groups.







HYDRO IN THE COMMUNITY

During 1986, as in previous years, Hydro's employees gave freely of their time and talents as they participated in numerous volunteer activities in communities throughout the Province. This type of commitment to the well-being of the community is encouraged by Hydro and it is indeed gratifying to witness its extent and effect.

The Hydro Group must continue to plan for its future and, in so doing, must encourage academic excellence among those who are currently in high school and post secondary institutions of learning. Consistent with this awareness, a scholarship program for children of employees was approved. The objective of this program is to encourage high performance among high school students and to stimulate a desire to continue with post secondary studies.

Hydro also extended its general scholarship program for students attending Memorial University, the Cabot Institute and the Marine Institute. In addition, we continued our program of hiring work-term students from the engineering and business schools of the university. Tangible support was also given to the Shad Valley program which provides an opportunity each summer for exceptionally talented students from across Canada, with an interest in high technology, to come together and participate in activities designed to stimulate their interest.

RATES

On January 1, 1986 Hydro implemented, with the approval of the Public Utilities Board, a Rate Stabilization Plan. This was a major change to Hydro's rate structure and provided customers with stable energy pricing for the first time since the mid 1970s.

Prior to 1986 customers were charged a base rate plus a fuel adjustment charge. This meant that customers' bills fluctuated from month to month, sometimes dramatically, because of the weather induced vagaries associated with the proportions of electricity produced from hydro and thermal sources and the ever-changing cost of fuel. The variations in Hydro's costs which inevitably resulted from these continually changing conditions were reflected in customers' bills each month and created budgeting difficulty for customers.

The Rate Stabilization Plan absorbs the variances between anticipated production costs and actual results and enables the deferral of these variances until predetermined dates when rates will be adjusted. Such adjustments, which are designed to amortize the balance in the Plan over three years, will be implemented automatically on July 1st of each year starting in 1987.

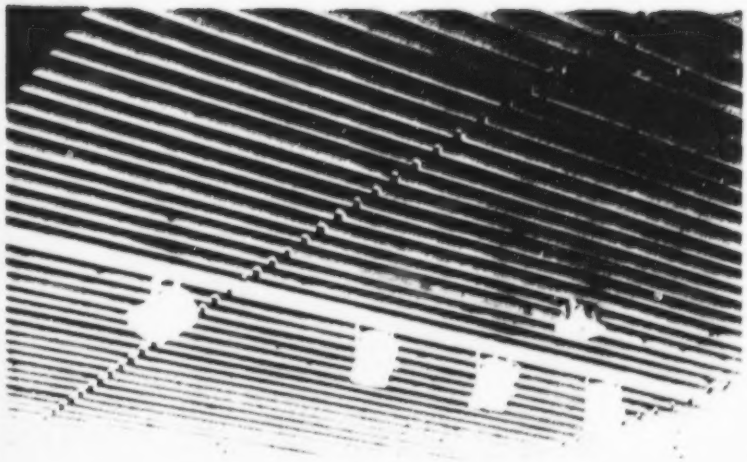
FINANCE

During 1986 a Depreciation Policy Study was undertaken and completed for the purposes of reviewing and evaluating the methods and procedures applied by Hydro in depreciating its fixed assets and comparing Hydro's approach with those of other electric power utilities in North America. The Study also reviewed and evaluated the service lives assigned to our fixed assets and compared them with those used in the electric utility industry generally.

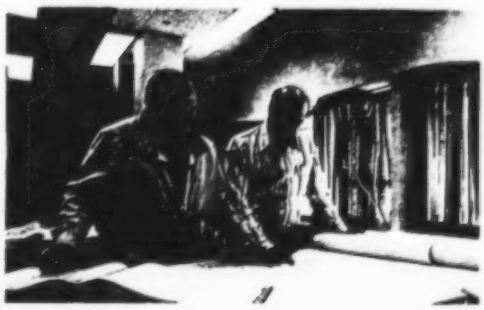
Hydro made the Study to fulfill an undertaking given to the Public Utilities Board during a 1985 public hearing with respect to Hydro's rates. The Study will be reviewed by the Public Utilities Board during the next Hydro rate referral, scheduled for 1988.

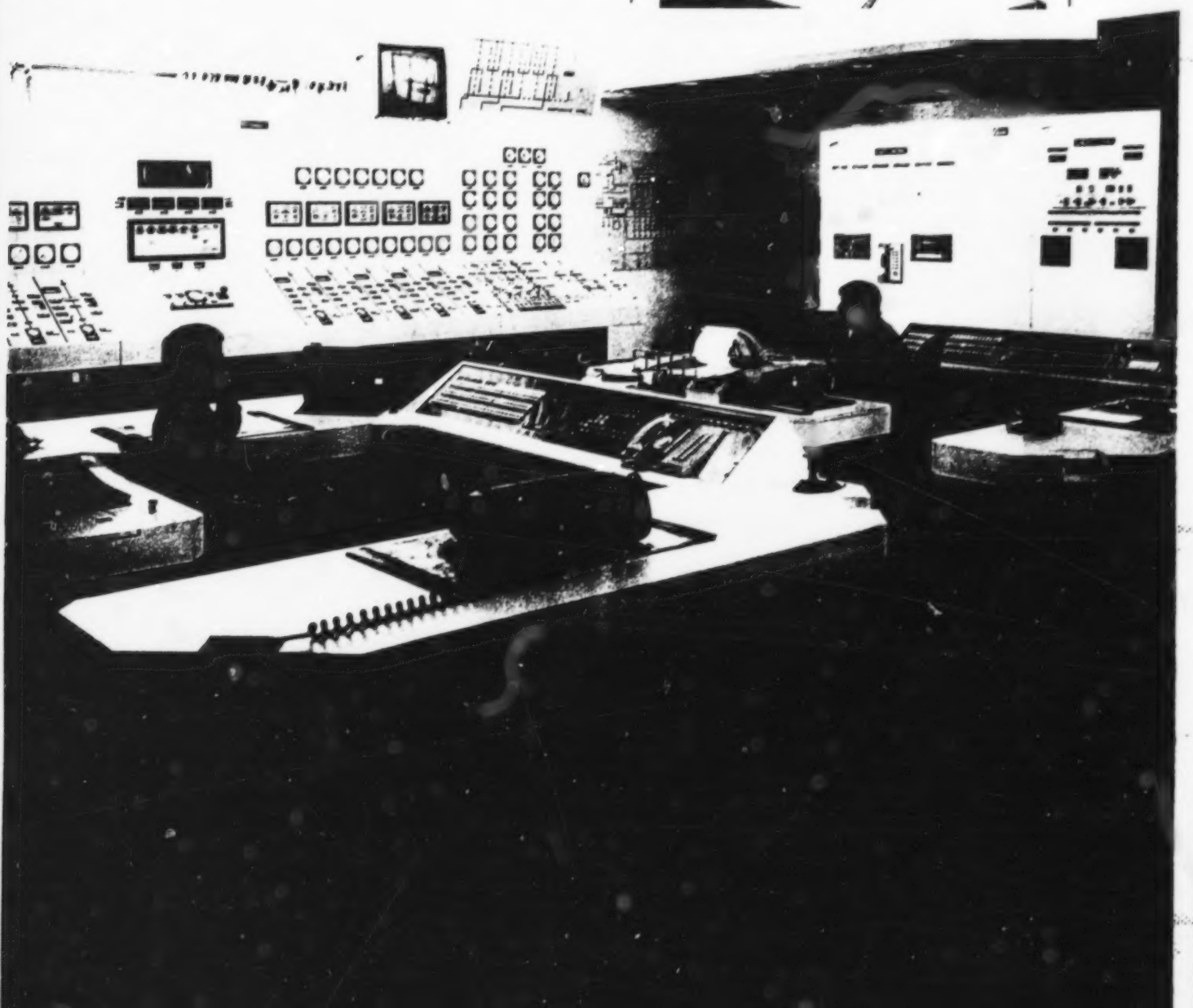
State of the art technology was brought to the Controller's Department during 1986 with the successful implementaiton of a new computerized financial reporting system for use in budgeting, accounting and financial reporting. This system greatly increases our ability to extract and use financial data for varying purposes and also enables the automatic production of many frequently used accounting reports and analyses.

During the year Hydro raised $100 million in the Canadian capital market by an issue of long term debentures. The issue bears interest at 9⅞% and has a term of 10 years. Proceeds of this issue were used to retire short term debt as part of Hydro's debt management strategy.



REVIEW OF CHURCHILL FALLS OPERATIONS





The year was an extremely busy one for everyone associated with Churchill Falls (Labrador) Corporation Limited (CF(L)Co) as we again reached our operating objectives, both under the long-term Power Contract with Hydro-Quebec and our contracts with Newfoundland and Labrador Hydro and Twin Falls Power Corporation Limited.

Nevertheless, the year was not without its operational difficulties. Two generating units were unavailable for service for part of the year and a 735 kV transformer bushing failure resulted in the necessity of shipping the large transformer back to the factory.

Despite these unscheduled developments that were attributable to causes outside the corporation's control, annual inspections were carried out on all generating units with one unit being rewedged. Of the eleven generating units, ten were in service during the latter part of the year, thereby enabling our Operations and Engineering Division to meet the requirements of the various power contracts.

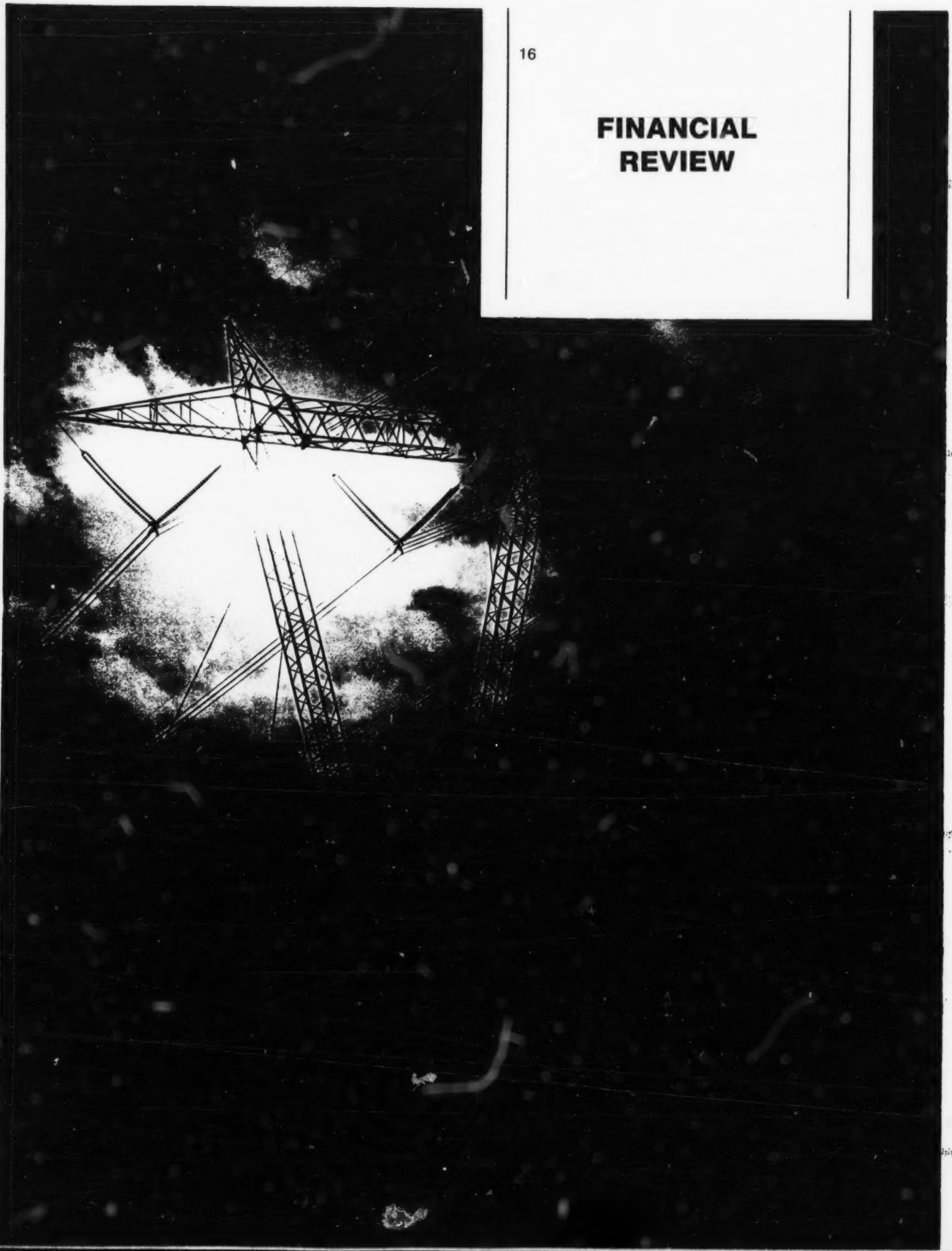
The Corporation produced 33,831 GWh which was 93% of the average production year capability of 36,337 GWh. This lower than average production is attributed to low water inflows into our reservoirs which were only 89% of average. 30,666 GWh were sold to Hydro-Quebec and this represents a 3.6% decline in sales from the previous year, while sales to customers in Labrador increased by 5% to 2,447 GWh.

The Corporation's net income for the year amounted to $33.1 million compared with $37.2 million for the preceding year. This decrease was the combined result of reduced power sales and increased expenses. Dividends amounted to $31.4 million, a decrease of approximately $1.3 million from the preceding year.

During the year many employees of the Corporation were active participants in the Loss Control Program which has recently been instituted for the Hydro Group. Many employees also participated in the various training programs of the Group with regard to safety, supervisory development and computer technology.

The production and sale of electricity at Churchill Falls is the result of a coordinated effort of many people in a variety of professions and trades who work as a cohesive unit in meeting the Corporation's objectives. They reside in a town which is owned and operated by the Corporation and which is serviced by many of the amenities which are sometimes available only in much larger centers. The Community functions in a healthy atmosphere where a large number of volunteers contribute significantly to the high quality of life for the approximately 850 residents.

FINANCIAL REVIEW



CONSOLIDATED FINANCIAL PERFORMANCE

Net Income

Hydro's net income in 1986 was $22.1 million and its share of CF(L)Co's net income was $14.4 million for a total consolidated net income of $36.5 million. Consolidated net income is up $7.4 million from 1985 and reflects the implementation of the alteration in rates and rate structure for Hydro's utility customers as recommended by the Public Utilities Board in 1985. Coincident with the changes in its rates to utility customers, Hydro made similar alterations in its rates and rate structure for its industrial customers. Both rate changes were effective January 1, 1986.

Revenue

Gross revenue in 1986 was $320.8 million with $314.0 million representing energy sales which decreased by $9.7 million, or 3.0% from 1985.

The 1986 sales volumes to utility and industrial customers increased by 1.5% and 4.4% respectively. However, revenues from these customers decreased to reflect Hydro's fixing of rates based on lower anticipated fuel prices in 1986 than those prevailing in 1985. Export sales revenue decreased by $1.9 million or 2.1% from 1985 due to a 3.6% decrease in the volume of sales.

Expenses

Total expenses in 1986 amounted to $274.9 million compared to $290.5 million in 1985, a decrease of 5.4%.

The total cost of fuel and purchased power was $54.6 million in 1986, down $41.1 million (42.9%) from 1985. This decrease was primarily due to the displacement of thermal generation with hydro generation from the Cat Arm plant which was in service for the full year. The Cat Arm plant is capable of displacing 1.1 million barrels of Bunker "C" fuel per year.

Operations and administration costs amounted to $53.2 million in 1986, an increase of $2.8 million from 1985. This was primarily related to higher repair and maintenance, insurance and other costs associated with placing new facilities in service.

Net interest expense charged to operations in 1986 was $144.2 million, up $22.8 million (18.8%) from 1985 and is primarily the result of the Cat Arm plant being in service for the full year.

Capital Expenditures

Capital expenditures in 1986 amounted to $26.5 million for the Hydro Group and were mainly associated with transmission and distribution facilities.

CF(L)Co

Hydro's income from CF(L)Co was as follows:

	1986	1985
Share of earnings	$22.6	$25.0
Rental and royalty	5.1	5.4
	27.7	30.4
Less: Interest on debt financing the investment	13.3	16.4
Net income effect	$14.4	$14.0

During 1986 CF(L)Co paid dividends of $22.6 million to Hydro and $8.8 million to Hydro Quebec.

Financial Information - 1986 ($ Millions)

	Hydro	CF(L)Co	Total
Revenue	224.3	93.5	317.8
Expenses:			
Operations & Administration	29.1	24.1	53.2
Fuels	53.6	—	53.6
Power purchased	3.5	—	3.5
Depreciation	8.5	13.3	21.8
Interest	107.5	23.1	130.6
	202.2	60.5	262.7
Net Operating Income	22.1	33.0	55.1
Interest on CFLCo Acquisition & Other Dedicated Costs	—	(9.2)	(9.2)
Minority Interest	—	(9.4)	(9.4)
Net Income to Hydro	22.1	14.4	36.5

The foregoing table shows the financial results of each corporate entity. Certain figures differ from the Consolidated Statement of Income due to various inter-company transactions which are eliminated upon consolidation.

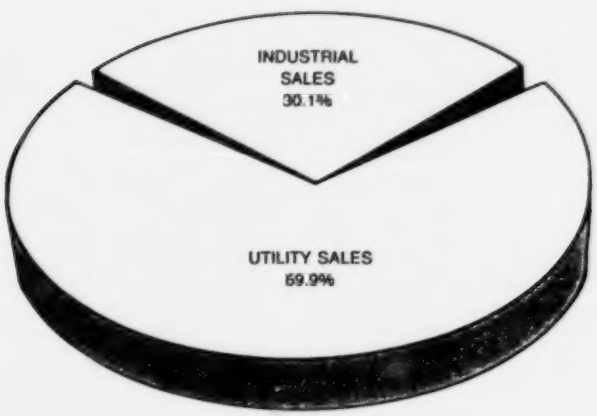
FINANCIAL PERFORMANCE - HYDRO OPERATIONS

Hydro's financial performance improved in 1986. The capital structure continued to improve and interest coverage returned to the range which has been accepted as appropriate to satisfy the requirements of The Electrical Power Control Act. The following table shows Hydro's primary financial measurements for the past five years:

Financial Measurements

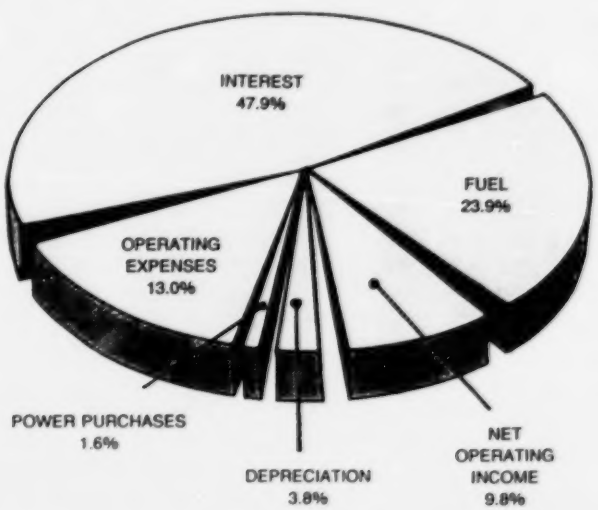
Year	Interest Coverage	Capital Structure (%) Debt	Equity
1986	1.19	88	12
1985	1.13	90	10
1984	1.19	91	9
1983	1.16	92	8
1982	1.22	93	7

ENERGY SALES
1986



APPLICATION OF REVENUES HYDRO OPERATIONS
1986

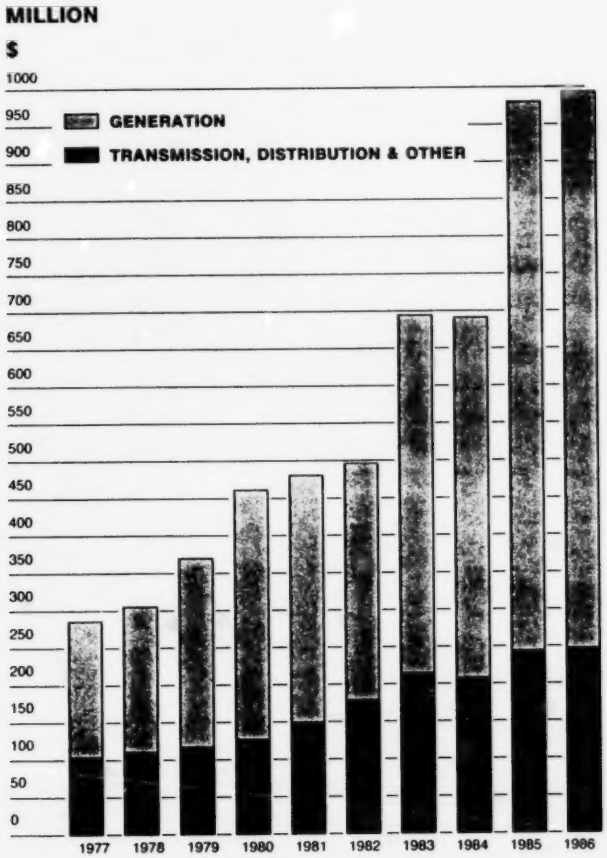
TOTAL REVENUES $ 224,269,000



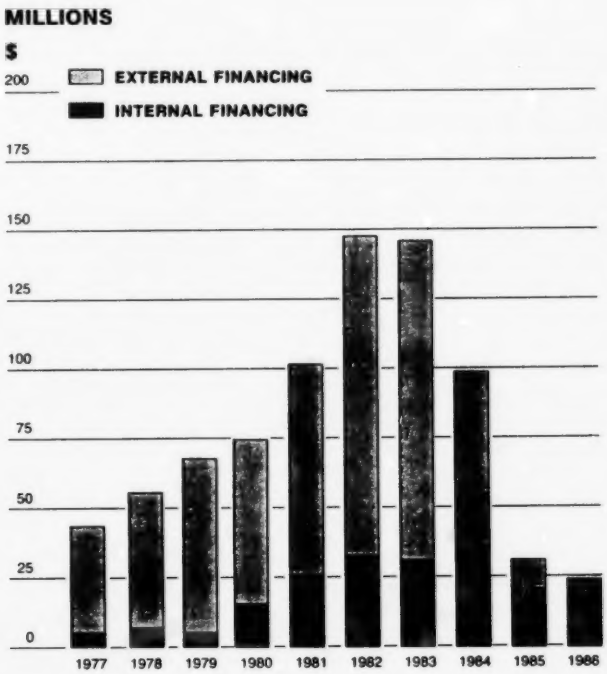
Hydro's interest coverage from its unconsolidated operations, which include both industrial and utility sales, was 1.19 in 1986 and reflects the alterations implemented on January 1, 1986 in the rates and rate structure for both classes of customers. This level of coverage is within the approved range of 1.15 to 1.25. It is expected that Hydro will stay within this range without adjusting its rates until 1988.

Hydro's capital program declined in 1986 and will continue at relatively modest levels until construction begins on the next major source of generation.

NET BOOK VALUE OF ASSETS IN SERVICE HYDRO OPERATIONS



FINANCING OF CAPITAL EXPENDITURES HYDRO OPERATIONS



FINANCIAL PERFORMANCE -

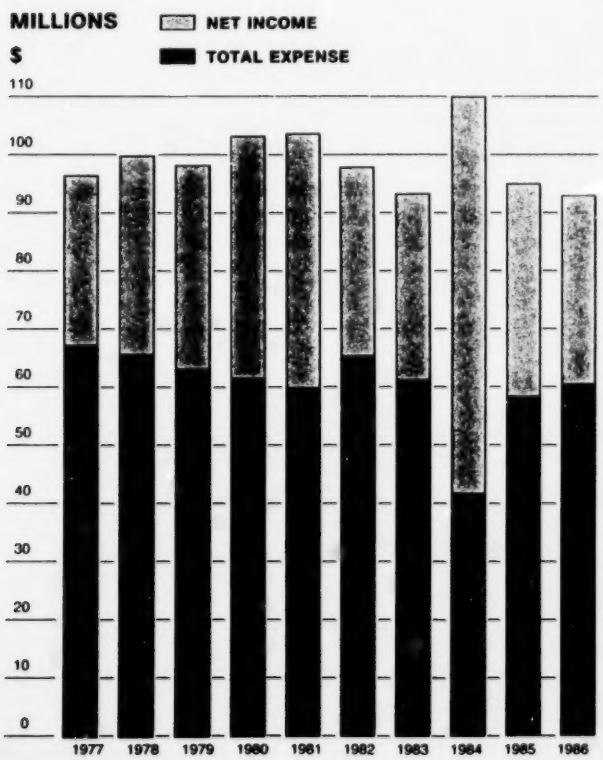
CF(L)Co OPERATIONS

Revenue from energy sales in 1986 amounted to $92.2 million of which 96.6% represents revenue from energy sales to Hydro-Quebec with the remainder for sales to Newfoundland and Labrador Hydro and Twin Falls Power Corporation Limited. 1986 revenue declined $2.2 million from 1985 which is primarily due to a 3.6% decrease in the volume of sales to Hydro-Quebec.

Operating expenses for the year, excluding rental and royalties, interest and depreciation, amounted to $19.0 million compared with $17.5 million in 1985. This increase of $1.5 million from 1985 is primarily due to increased maintenance and major repairs to the generating units.

Net interest and exchange expense in 1986 amounted to $23.1 million compared with $22.3 million in 1985. This increase is primarily related to a reduction in the discount realized on debt retirement.

COMPOSITION OF TOTAL REVENUE CHURCHILL FALLS OPERATIONS



MANAGEMENT REPORT

The consolidated financial statements of Newfoundland and Labrador Hydro have been prepared by management in accordance with Canadian generally accepted accounting principles consistently applied and including information available up to March 25, 1987. The integrity and objectivity of the data in these financial statements, including estimates and judgments relating to matters not concluded by year end, are the responsibility of Management. Financial information presented elsewhere in the Annual Report is consistent with that in the consolidated financial statements.

Management maintains systems of internal accounting controls and procedures to provide reasonable assurance at reasonable cost that its assets are safeguarded against loss from unauthorized use or disposition and that the financial records provide a reliable basis for the preparation of financial statements and other data, as well as maintaining accountability for corporate assets.

Hydro's external auditors provide an objective, independent review of management's discharge of their responsibilities as they relate to the fairness of reported consolidated operating results and financial conditions of Hydro in accordance with generally accepted auditing standards.

The Board of Directors pursues its responsibility for these financial statements principally through its Audit Committee, composed solely of outside directors. This Committee meets periodically with management, as well as with the internal and external auditors who have full and free access to the Audit Committee, and meet with it, with and without management being present, to discuss auditing and financial reporting matters.

Management is responsible for and the Board of Directors has approved, all of the information in the Annual Report.

Cyril J. Abery

Chairman of the Board and
Chief Executive Officer

David L. Vardy

President

R.G. Grant

Vice-President, Finance
& Chief Financial Officer

March 25, 1987
St. John's, Newfoundland

Newfoundland an
Consolidate

(in thousand

Assets

	December 31	
	1986	1985
Fixed assets (Note 2)		
Property, plant and equipment	**$1,901,800**	**1,900,274**
Current assets		
Cash and term deposits	**45,116**	**43,892**
Receivables	**52,470**	**52,359**
Fuel and supplies at average cost	**27,076**	**32,957**
Prepaid expenses	**2,061**	**3,368**
Water equalization receivable (Note 9)	**—**	**7,843**
	126,723	**140,419**
Long-term receivables (Notes 3 and 11(b))	**20,997**	**25,260**
Investment in Twin Falls Power Corporation Limited (Note 4)	**3,761**	**3,456**
Lower Churchill option (Note 5)	**5,200**	**5,200**
Deferred charges (Note 6)	**36,847**	**29,818**
	$2,095,328	**2,104,427**

abrador Hydro
alance Sheet

ollars)

Liabilities and Shareholder's Equity

	December 31	
	1986	**1985**
Long-term debt (Notes 8 and 10)	**$1,421,714**	**1,411,392**
Current liabilities		
Accounts payable and accrued liabilities	**21,868**	**24,837**
Water equalization refundable (Note 9)	**8,391**	**16,234**
Accrued interest	**34,891**	**32,618**
Long-term debt due within one year	**77,936**	**48,166**
Promissory notes (Note 10)	**30,955**	**102,380**
	174,041	**224,235**
Water equalization refundable (Note 9)	**5,642**	**14,033**
Rate stabilization	**2,107**	**—**
Minority interest in Churchill Falls (Labrador) Corporation Limited	**102,605**	**102,023**
Minority interest in Lower Churchill Development Corporation Limited	**14,750**	**14,750**
Shareholder's equity		
Share capital		
Common shares of par value of $1 each. Authorized 25,000,000 shares; issued 22,503,942 shares	**22,504**	**22,504**
Contributed capital (Note 5)		
Lower Churchill Development	**15,400**	**15,400**
Muskrat Falls Project	**2,165**	**2,165**
Gull Island Project	**100,000**	**100,000**
Retained earnings	**234,400**	**197,925**
	374,469	**337,994**
	$2,095,328	**2,104,427**

See accompanying notes

ON BEHALF OF THE BOARD

Director

Director

Newfoundland and Labrador Hydro
Consolidated Statements

(in thousands of dollars)

Consolidated Statement of Income

	For the year ended December 31	
	1986	**1985**
Revenue		
Energy sales	$ 314,030	323,707
Rentals and royalties	5,842	5,378
Other	907	1,473
	320,779	330,558
Expenses		
Operations and administration	53,166	50,400
Fuels	53,571	95,059
Power purchased	1,042	660
Depreciation	22,955	22,948
Interest (Note 12)	144,214	121,418
	274,948	290,485
Net income from operations	45,831	40,073
Minority interest	9,356	11,008
Net income for the year	$ 36,475	29,065

Consolidated Statement of Retained Earnings

	For the year ended December 31	
	1986	**1985**
Balance beginning of year	$ 197,925	168,860
Net income for the year	36,475	29,065
Balance end of year	$ 234,400	197,925

Changes in Financial Position

	For the year ended December 31	
	1986	**1985**
Operating activities		
Net income from operations	$ 45,831	40,073
Add (deduct) items not involving a cash flow		
Water equalization	—	(5,733)
Depreciation	22,955	22,948
Amortization of deferred exchange loss	1,414	507
Other amortization	2,576	2,620
Rate stabilization plan	2,107	—
Other	(459)	(456)
	74,424	59,959
Miscellaneous	1,835	1,817
Reduction in water equalization	(8,391)	—
Net change in other non-cash working capital balances related to operations	7,240	(5,547)
Cash provided by operating activities	75,108	56,229
Investment activities		
Additions to deferred charges	(11,019)	(527)
Additions to property, plant and equipment	(26,462)	(35,403)
Reduction in long-term receivables	4,263	4,137
Dividends received from Twin Falls Power Corporation Limited	300	—
Net change in payables and receivables relating to investing activities	(859)	(3,973)
Cash used in investment activities	(33,777)	(35,766)
Financing activities		
Issue of long-term debt	100,000	37,349
Reduction in long-term debt	(59,908)	(80,584)
Dividends paid by a subsidiary to a minority interest	(8,774)	(9,462)
Increase (decrease) in promissory notes	(71,425)	25,977
Cash used in financing activities	(40,107)	(26,720)
Net increase (decrease) in cash	1,224	(6,257)
Cash position at beginning of year	43,892	50,149
Cash position at end of year	$ 45,116	43,892

See accompanying notes

Newfoundland and Labrador Hydro
Notes to Consolidated Financial Statements
December 31, 1986

Newfoundland and Labrador Hydro ("Hydro") is incorporated under a special act of the Legislature of the Province of Newfoundland (the "Province") as a Crown corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary companies are exempt from paying income taxes under Section 149(1)(d) of the Income Tax Act.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles as established in Canada. In order to match revenues and costs and to conform with recommendations of the Board of Commissioners of Public Utilities ("PUB"), Hydro's accounting for foreign exchange differs from that recommended by the Canadian Institute of Chartered Accountants.

Rates and regulations (excluding sales by subsidiaries)

The rates charged by Hydro, excluding sales by subsidiaries, are governed by the Electrical Power Control Act (the "Act"). Under the Act, Hydro is required to charge rates to all its customers designed "to recover the cost of service provided by it and a margin of profit sufficient to achieve and maintain a sound financial position so it is able to achieve and maintain a sound credit rating in the financial markets of the world". There are presently four long-term contracts with industrial customers which were entered into prior to the coming into being of the Act and which do not allow Hydro to recover costs plus a margin of profit and therefore require payments from the Province to Hydro in order to ensure that Hydro meets the requirements of the Act. These payments were $18,761,000 for year ended December 31, 1986 (1985 $25,968,000).

Rates proposed for utility customers from which approximately 69.8% of Hydro's revenue is derived (1985 68.4%) are subject to public hearings, following which the PUB recommends rates to the Province. If the Province does not change the rates recommended by the PUB within 15 days, the recommended rates become effective. Should the Province approve rates which are lower than those recommended by the PUB, the Act requires the Province to enter into financial and other arrangements as may be necessary to enable Hydro to conform to the Act quoted above. The Province has accepted all rate recommendations of the PUB to date. Rates, compatible with the Act, charged to industrial customers, are set by the Board of Directors of Hydro. The PUB has determined that Hydro's net income from operations should provide coverage of from 1.15 times to 1.25 times its gross interest cost in order to achieve the profit margin required by the Act. The coverage from operations in 1986 was 1.19 (1985 1.13).

Principles of consolidation

The consolidated balance sheet includes the accounts of Hydro and those of its subsidiary companies, Churchill Falls (Labrador) Corporation Limited ("CF(L)Co"), (65.8% owned), Gull Island Power Company Limited ("GIPCo"), (100% owned), and Lower Churchill Development Corporation Limited ("LCDC"), (51% owned).

CF(L)Co is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador and having a rated capacity of 5,400,000 kilowatts ("kW") (the "CF(L)Co Project").

The cost of the investment in CF(L)Co exceeds the equity in the book value of the net assets acquired by $77,148,000. This amount is assigned to property, plant and equipment and is being written off on a straight-line basis at the rate of 1½% per annum. As at December 31, 1986 $13,887,000 (1985 $12,729,000) had been written off.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, (the "Lease"), CF(L)Co must pay rentals and royalties to the Province annually. These rentals and royalties have been assigned to Hydro.

A portion of Hydro's shareholding in CF(L)Co is deposited in a voting trust pursuant to an agreement with Hydro-Quebec with whom CF(L)Co has a long-term power contract.

GIPCo is incorporated under the laws of Canada and was established with the objective of developing the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and of constructing a direct current transmission system from Labrador to the island of Newfoundland (the "Gull Island Project"). (See Note 5)

LCDC is incorporated under the laws of Newfoundland and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (the "Lower Churchill Development"). (See Note 5)

Although CF(L)Co owns voting control (66⅔%) of Twin Falls Power Corporation Limited ("TWINCo"), the equity interest is 33⅓%, and as the principal assets and credit resources of TWINCo cannot be transferred to CF(L)Co, consolidation is not considered appropriate and the investment is carried on an equity basis.

Fixed assets and depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

Hydro, GIPCo and LCDC

Plant under construction includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to plant under construction at rates equivalent to the weighted average cost of the most recent funds borrowed. The average rate for the year ended December 31, 1986 was 9¾% (1985 11⅜%).

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation	
Hydroelectric	50, 75 and 100 years
Thermal electric	25 and 30 years
Diesel electric	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years

CF(L)Co

Depreciation is provided for at a rate of 1½% per annum on a straight-line basis.

Deferred charges

Debt discount and financing expenses

These costs are, in general, amortized on a straight-line basis over the lives of the respective debt issues.

Deferred foreign exchange loss

CF(L)Co's unrealized foreign exchange loss, net of accumulated charges to income, is amortized over the remaining life of the related long-term debt.

In 1985, the PUB accepted the inclusion of realized foreign exchange losses in rates charged to customers commencing in 1986 for Hydro. Any such loss not recovered due to the operation of the rate setting process is deferred to the time of the next rate hearing for inclusion in the new rates set at that time.

Deferral of major repairs

Subject to PUB approval, cost of major repairs of an extraordinary and non-recurring nature are amortized to income over periods ranging from five to ten years commencing in the year in which they are incurred. The PUB has accepted the inclusion of these charges in determining Hydro's regulated rates.

Feasibility studies and other

These costs are amortized on a straight-line basis over a five year period.

Rate Stabilization Plan

On January 1, 1986 Hydro, having received the concurrence of PUB, implemented a rate stabilization plan which provides for the deferral of cost variances resulting from changes in fuel prices, levels of precipitation and load. The balance in the plan on July 1, 1987 and annually thereafter, will be amortized over a three year period. Adjustments required in the retail rates to reflect the amortization of the balance in the plan will be automatic on July 1 of each year. Similar adjustments required in industrial rates will be automatic on January 1 of each year.

Foreign currencies

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities, except for long-term debt and its related current portion, are translated using exchange rates at that date.

(i) In the case of Hydro, long-term debt including current portion is translated in accordance with rate making practices, at exchange rates prevailing when the debt was incurred. Therefore, no recognition is given in the accounts to unrealized gains or losses.

(ii) Under the provisions of the contract between CF(L)Co and Hydro-Quebec (the "Power Contract") CF(L)Co's exposure for a foreign exchange loss is limited. CF(L)Co recovers a portion of the difference between actual exchange rates prevailing at the settlement date of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract.

The unrealized foreign exchange loss not recoverable under the Power Contract has been deferred and is being amortized to operations over the remaining life of the debt.

(c) Recorded gains or losses on foreign currencies are included with interest in the statement of income.

2. FIXED ASSETS

	1986 (000)	1985 (000)
Hydro		
Property, plant and equipment, at cost	$1,143,058	1,121,895
Less contributions in aid of construction	71,582	71,895
	1,071,476	1,050,000
Less accumulated depreciation	82,532	73,148
	988,944	976,852
Plant under construction	9,412	7,084
	998,356	983,936
GIPCo		
Gull Island Project, at cost (Note 5)	98,563	98,692
CF(L)Co (a)		
Property, plant and equipment at cost	963,237	961,743
Less accumulated depreciation	182,726	168,324
	780,511	793,419
LCDC		
Capital studies (Note 5)	24,370	24,227
	$1,901,800	1,900,274

(a) CF(L)Co assets are pledged as security for its long-term debt.

3. LONG-TERM RECEIVABLES

	1986 (000)	1985 (000)
CF(L)Co — initial review period	$20,577	24,987
four year review	420	273
	$20,997	25,260

This receivable relates to the additional revenue referred to in Note 11(b) plus interest. Payments of the amount related to the initial review period will be received in monthly instalments over an eight-year period which commenced September 1, 1984 with the receivable bearing interest at 7% per annum, which interest is payable concurrently with each instalment. Payments of the amount related to the four year review will commence in 1988.

4. INVESTMENT IN TWIN FALLS POWER CORPORATION LIMITED

	1986 (000)	1985 (000)
Shares, at cost	$2,500	2,500
Equity in retained earnings at beginning of year	956	403
Equity in net income for the year	605	553
Dividends for the year	(300)	—
	$3,761	3,456

5. LOWER CHURCHILL DEVELOPMENT

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (the "Principal Agreement"), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Upon agreement to continue with the Lower Churchill Development, GIPCo's assets and the hydroelectric development rights to the Lower Churchill River, (the "Water Rights"), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, (the "Option Agreement"). The purchase price in respect of GIPCo's assets will be a maximum of $100,000,000 less $5,200,000 representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo's assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94,800,000. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The Option Agreement expires November 24, 1987 and it is not anticipated that there will be any loss upon sale of GIPCo's assets to LCDC.

Hydro has acquired 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

In 1980, the LCDC Board of Directors issued a report to the shareholders recommending development of the Muskrat Falls site and the transmission of this power to the island of Newfoundland. Engineering studies for the transmission system have been completed but a final commitment to the project awaits the resolution of the Churchill Falls issues. (See Note 13(a)).

6. DEFERRED CHARGES

	1986 (000)	1985 (000)
Unamortized debt discount	$14,859	15,389
Deferred foreign exchange loss	19,213	11,709
Major repair costs	990	1,344
Feasibility studies and other	1,785	1,376
	$36,847	29,818

7. POWER DISTRIBUTION DISTRICT

Hydro administers the Power Distribution District of Newfoundland and Labrador ("PDD"), a statutory corporation of the Province. PDD is responsible for the provision of electricity to its customers in certain remote rural communities. Hydro finances the capital requirements of PDD, manages PDD's operating responsibilities and is fully reimbursed for all costs associated therewith.

8. LONG-TERM DEBT

	1986			1985
	Hydro	CF(L)Co	Total	Total
	(000)	(000)	(000)	(000)
Summary of long-term debt				
Bonds, notes and debentures	$836,189	504,742	1,340,931	1,328,534
Government of Canada loans	80,783	—	80,783	82,858
Total long-term debt	$916,972	504,742	1,421,714	1,411,392

At December 31, 1986 it is estimated that required repayments of long-term debt over the next five years will be as follows:

	(000)
1987	$ 78,000
1988	78,300
1989	127,700
1990	51,200
1991	43,900

Details of long-term debt are as follows

Hydro

Bonds, notes and debentures, redeemable at the option of Hydro at various times and at various rates, none of which exceeds 102¼% of par.

Interest Rate %		Year of Maturity	Foreign Funds		1986	1985	
				(000)	(000)	(000)	
5¼		1990	U.S.	$12,560	13,556	15,585	(a)
7¾		1993	U.S.	$25,000	26,773	26,773	(b)
9		1994	U.S.	$ 9,600	10,321	10,804	
9¾		1986			—	20,535	
8⅛		1992			15,000	15,000	(b)
8⅞		1999			20,000	20,000	(b)
10¾		1995			25,000	25,000	(b)
6⅛		1992	S.Fr.	75,000	28,286	28,286	
10¼		2001			30,000	30,000	(b)
10		2002			30,000	30,000	(b)
10	Series J	2002			35,000	35,000	(b)
10¼	Series K	2001			35,000	35,000	(b)
10	Series L	2003			40,000	40,000	(b)
9⅞		1994	U.S.	$50,000	57,797	57,797	
11¼	Series M	1999			110,000	110,000	(b)
13⅜	Series N	2001			75,000	75,000	(b)
17¼		1989	U.S.	$75,000	88,876	88,876	
15⅛		1992	U.S.	$100,000	124,072	124,072	
15¼	Series Q	1987			50,000	50,000	
11¼	Series R	1988			50,000	50,000	
7⅜		1995	¥	7,000,000	37,349	37,349	
9⅞	Series S	1996			100,000	—	
					1,002,030	925,077	
Less sinking funds					105,780	86,391	
					896,250	838,686	
Less payments due within one year					60,061	30,596	
					$836,189	808,090	

(a) Secured by an assignment of amounts receivable under a power contract.

(b) A sinking fund has been established for this issue.

Government of Canada loans

These loans, in the aggregate amount of $82,858,000 (1985 $84,798,000), including the current portions, bear interest at various rates from 5¼% to 8½% and each loan is repayable following the completion date of the related facility, by thirty or forty equal annual instalments including interest. The years of maturity of these loans range between 2003 and 2014, and the current portion as at December 31, 1986 was $2,075,000 (1985 $1,940,000).

Based on exchange rates in effect at December 31, 1986, the approximate amount required to discharge foreign currency debt obligations recorded in the accounts in Canadian dollars as $387,030,000 would be $501,159,000 (1985, as $410,078,000 would be $512,957,000).

CF(L)Co

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments which commenced in June 1978.

The Deed of Trust and Mortgage securing the General Mortgage bonds provides for semi-annual sinking fund payments which commenced in June 1980. Each payment will be equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

	1986	1985
	(000)	(000)
First Mortgage Bonds		
7¾% Series A due December 15, 2007 (U.S. $374,845,000)	$396,147	408,728
7⅞% Series B due December 15, 2007	37,582	38,761
General Mortgage Bonds		
7½% due three years after latest maturity of any First Mortgage Bonds	86,813	88,585
	520,542	536,074
Less payments due within one year	15,800	15,630
	$504,742	520,444

9. WATER EQUALIZATION

In order to equalize the effect on thermal generation cost due to fluctuations in water availability, Hydro charged or credited fuel expense in the income statement annually with an amount calculated to adjust generation costs to an average annual water condition. The calculation was based on historical water flow data compiled over a period of 36 years. The offsetting debit or credit was included in the water equalization provision account. This practice was accepted by the PUB in determining Hydro's regulated rates up to December 31, 1985.

On January 1, 1986 Hydro implemented a rate stabilization plan which includes a water variation provision component and the water equalization provision was discontinued. The balance in the water equalization provision at December 31, 1985 was $30,267,000. Of this amount, $7,843,000 was used to extinguish a related receivable from the Government. The remainder is being refunded to customers over a three year period which commenced January 1, 1986.

10. GUARANTEES BY THE PROVINCE

The Province has unconditionally guaranteed the principal and interest on promissory notes and long-term debt, except for the Swiss franc loan and the debt of CF(L)Co.

11. SALES OF POWER, CF(L)Co

(a) The Power Contract provides for the sale of substantially all of the energy from the CF(L)Co Project for an initial period of 40 years, until 2016, with an automatic renewal for a further period of 25 years. Sales of power under the Power Contract have been recorded at mill rates based on a determination by an independent auditor that the Final Capital Cost of the Project is $887,575,000. Hydro-Quebec and CF(L)Co implemented an increase in rates during 1981 without prejudice to the right of either party in further negotiations or in a judicial review of the Final Capital Cost pursuant to the provisions of the Power Contract. CF(L)Co instituted proceedings in November, 1984 in the Quebec Superior Court claiming that the Final Capital Cost is in excess of $900,000,000, the maximum to be used as a basis for the mill rate. Hydro-Quebec filed a preliminary motion concerning whether CF(L)Co could institute the action, which motion was heard January 21, 1985. On February 11, 1985 the court upheld the preliminary motion and stated that it lacked jurisdiction over the subject matter of the action as drafted by CF(L)Co. CF(L)Co has appealed this judgement.

(b) The terms Energy Payable and Annual Energy Base are defined in the Power Contract. Section 8.5.2 of the Power Contract provides for an initial eight-year review and subsequent four-year reviews of the annual average Energy Payable for comparison with the Annual Energy Base then in effect. When the annual average Energy Payable exceeds the Annual Energy Base in effect an additional payment is due from Hydro-Quebec, the amount being calculated in accordance with Article VIII of the Power Contract. Conversely, if a shortfall should occur, a refund would be due from CF(L)Co to Hydro-Quebec. Article IX of the Power Contract provides for adjustment to the Annual Energy Base where applicable in the same time intervals.

Energy delivered to Hydro-Quebec during the period September 1, 1976 to August 31, 1984 was reviewed in September 1984 to determine the annual average Energy Payable for comparison with the Annual Energy Base in effect during the period. The annual average Energy Payable during the initial period was determined to be in excess of the Annual Energy Base, thereby resulting in an adjustment in 1984. The Annual Energy Base was also reviewed pursuant to Article IX and was increased from 31.5 billion kilowatthours ("kW.hs") (Hydro-Quebec 30.74 billion kW.hs) per annum to 32.2 billion kW.hs (Hydro-Quebec 31.44 billion kW.hs) per annum, the maximum permissible under the Power Contract.

12. INTEREST EXPENSE

	1986 (000)	1985 (000)
Gross interest		
Interest on long-term debt	$183,051	181,460
Interest on promissory notes	6,885	7,668
	189,936	189,128
Amortization of debt discount and financing expense	1,651	1,726
Exchange loss on sinking fund transactions and retirement of debt	1,949	177
	193,536	191,031
Less		
Recovered from:		
Hydro-Quebec (a)	24,605	26,798
PDD	4,833	4,134
Interest during construction	386	20,542
Interest earned	19,498	18,139
Net interest expense	$144,214	121,418

(a) Under the terms of the Power Contract, CF(L)Co recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, CF(L)Co can require Hydro-Quebec to make additional cash advances to service its debt and to cover its expenses if funds are not otherwise available. In exchange CF(L)Co will issue units of Subordinate Debentures and shares of common stock.

13. COMMITMENTS AND CONTINGENT LIABILITIES

(a) (i) A request was made by the Province in 1976 for CF(L)Co to supply 800,000 kW of power, pursuant to Clause 2(e) of Part I of the lease, to meet the Province's requirements commencing in 1983. This request was denied and legal action was commenced against CF(L)Co. The trial of this action concluded July 8, 1982 and on June 13, 1983 the Newfoundland Supreme Court, Trial Division denied the Province's request. This judgement was appealed to the Newfoundland Supreme Court, Court of Appeal which heard the appeal on October 15-18, 1984. On October 25, 1985, the Court of Appeal dismissed the Province's appeal. On May 22, 1986 the Supreme Court of Canada granted the Province leave to appeal this judgement. No date has been set yet for the hearing of the appeal.

(ii) In June 1977, Hydro-Quebec commenced an action against CF(L)Co in the Superior Court in Montreal seeking a declaration as to its rights under the Power Contract should CF(L)Co comply with the Province's request referred to in Note 13(a)(i). On August 4, 1983 judgement was rendered in which the Superior Court stated that, inter alia, failure by CF(L)Co to supply Hydro-Quebec all the power and energy pursuant to the Power Contract would be a breach of the Power Contract. This judgement was appealed by CF(L)Co and on February 18, 1985 the Quebec Court of Appeal rendered its judgement dismissing the appeal. On May 22, 1986 the Supreme Court of Canada granted CF(L)Co leave to appeal this judgement. No date has been set yet for the hearing of the appeal.

(b) Under the terms of a sublease with TWINCo, CF(L)Co is required to deliver to TWINCo, at an agreed price, horsepower equivalent to the installed horsepower of the TWINCo plant and to maintain in good working order, TWINCo's plant and equipment. The sublease expires on December 31, 1989 and has a 25-year renewal option subject to certain conditions.

(c) Hydro has received claims instituted by various companies with respect to construction costs, outages and plant shutdowns. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements is $1,000,000 (1985 $18,000,000). The final resolution of these matters is currently under negotiation.

(d) Hydro's employees are covered by the Province's Public Service Pension Plan to which contributions are made equally by Hydro and its employees. CF(L)Co has two private pension plans, one for salaried and one for hourly paid employees and in addition a number of salaried and hourly paid employees are covered by the Public Service Pension Plan. Both CF(L)Co plans are fully funded and managed by a trustee. Based on the most recent actuarial valuations, each CF(L)Co plan is in a surplus position.

(e) Hydro's outstanding commitments for capital projects total approximately $10,290,000 at December 31, 1986 (1985 $6,720,000).

14. STATEMENT OF CHANGES IN FINANCIAL POSITION

The 19 Statement of Changes in Financial Position focus on changes in cash. The 1985 comparative figures which were originally presented on a working capital basis, have been restated to conform to the 1986 presentation.

AUDITORS' REPORT

The Lieutenant-Governor in Council
Province of Newfoundland

We have examined the consolidated balance sheet of Newfoundland and Labrador Hydro as at December 31, 1986 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat Marwick Mitchell & Co.
Chartered Accountants

St. John's, Newfoundland
Canada
March 25, 1987

OPERATING STATISTICS

Years Ended December 31	1986	1985	1984	1983	1982	1981	1980
Installed generating capacity at end of period (rated kW in thousands)							
CF(L)Co	5,403	5,403	5,225	5,225	5,225	5,225	5,225
TWINCo	225	225	225	225	225	225	225
Hydro — Hydroelectric	891	891	764	764	680	680	680
— Thermal	638	637	637	637	638	636	634
Total	7,157	7,156	6,851	6,851	6,768	6,766	6,764
Electric energy generated, net of station services (kW.h in millions)							
CF(L)Co	33,721	34,777	38,910	33,819	38,242	38,958	40,680
Hydro — Hydroelectric	3,898	3,449	4,086	3,912	3,134	3,387	2,403
— Thermal	1,255	1,725	757	575	1,121	414	1,350
Total Available for Sale	38,874	39,951	43,753	38,306	42,497	42,759	44,433
Electric energy sales (kW.h in millions)							
CF(L)Co — Export	30,666	31,833	35,989	31,188	35,715	35,881	37,759
— Utility	3,590	3,536	3,246	3,033	2,992	2,724	2,751
— Industrial	2,059	1,975	1,856	1,783	1,628	1,424	1,340
Total	36,315	37,344	41,091	36,004	40,335	40,029	41,850
Average sales revenue (cents per kW.h)							
CF(L)Co — Export	0.29	0.29	0.26	0.29	0.26	0.27	0.26
Hydro — Utility	4.36	4.45	3.63	3.12	2.98	2.42	2.22
— Industrial	3.28	3.75	3.02	2.89	2.60	2.22	2.05
Transmission lines (kilometres)							
CF(L)Co — 735 kV	608	608	608	608	608	608	608
— 230 kV	431	431	431	431	431	431	431
Hydro — 230 kV	1,531	1,531	1,531	1,408	1,353	1,326	1,191
— 138 kV	916	916	916	916	916	845	845
— 69 kV	539	539	539	539	455	443	347
Total	4,025	4,025	4,025	3,902	3,763	3,653	3,422
Peak demand (kW in thousands)							
CF(L)Co System	5,203	5,614	5,530	5,562	5,685	5,680	5,669
Hydro System	1,084	1,009	1,013	1,040	881	834	836

*Decrease in thermal capacity is result of shutdown of diesel generating plants in accordance with Hydro's ongoing interconnect program.

FINANCIAL STATISTICS

(in millions of dollars) Years Ended December 31	1986	1985	1984	1983	1982	1981	1980
Operating Results:							
Revenue							
Energy sales	$ 314.0	323.7	268.9	236.1	225.0	195.6	185.7
Rentals and royalties	5.9	5.4	8.5	4.9	5.3	5.9	6.1
Other	0.9	1.5	*37.0	1.8	2.3	1.8	2.0
	320.8	330.6	314.4	242.8	232.6	203.3	193.8
Expenses							
Operations and administration	54.2	51.1	52.7	47.4	48.1	40.4	36.3
Fuels	53.6	95.1	49.4	31.7	40.2	17.5	21.7
Depreciation	23.0	22.9	22.3	22.2	22.4	22.1	21.1
Interest	144.2	121.4	117.0	115.4	91.2	91.7	85.3
	275.0	290.5	241.4	216.7	201.9	171.7	164.4
Net income before minority interest	45.8	40.1	73.0	26.1	30.7	31.6	29.4
Minority interest	9.3	11.0	22.1	9.7	10.6	13.0	12.4
Net income	36.5	29.1	50.9	16.4	20.1	18.6	17.0
Contributions to Net Income							
Hydro Corporate	22.1	15.0	19.7	14.3	16.5	10.8	8.4
CF(L)Co	14.4	14.1	31.2	2.1	3.6	7.8	8.6
Financial Position:							
Total current assets	126.7	140.4	135.4	112.3	183.4	144.3	95.2
Total current liabilities	174.0	224.2	168.5	147.0	121.2	108.2	125.8
Net working capital	(47.3)	(83.8)	(33.1)	(34.7)	62.2	36.1	(30.6)
Property, plant and equipment	2167.1	2141.8	2108.2	2011.9	1864.1	1712.4	1599.4
Accumulated depreciation	265.3	241.5	218.4	197.5	174.8	152.4	130.6
Property, plant and equipment net	1901.8	1900.3	1889.8	1814.4	1689.3	1560.0	1468.8
Other assets	66.8	63.7	77.7	35.8	35.2	34.1	32.6
Long-term debt	1421.7	1411.4	1474.3	1427.7	1425.5	1296.8	1177.9
Other liabilities	125.1	130.8	151.2	129.8	119.0	111.1	97.0
Shareholder's equity	374.5	338.0	308.9	258.0	242.2	222.3	195.9
Employees at year-end:							
Permanent	1,201	1,196	1,197	1,213	1,232	1,205	1,204
Temporary	132	113	107	93	95	126	157
Total	1,333	1,309	1,304	1,306	1,327	1,331	1,361

*Includes unusual item relating to a sale of power adjustment of $35.3

BOARD OF DIRECTORS AND OFFICERS – 1986

DIRECTORS

Newfoundland and Labrador Hydro

Cyril J. Abery, Chairman
Angus A. Bruneau*
Lawrence D. Fahey
Janet C. Gardiner
Edward M. Hearn
Roland T. Martin
Moses O. Morgan
David W. Mercer, Ex-officio

*Resigned 24 March 1986

Churchill Falls (Labrador) Corporation

Cyril J. Abery, Chairman
Guy Coulombe*
James J. Greene, Q.C.
John P. Henderson
David W. Mercer
Michael J. Monaghan, Q.C.
Georges Lafond**
David S. Templeton***
Jean Claude Roy****
Jean Bernier*****

* Resigned May 20, 1986
** Resigned July 24, 1986
*** Appointed February 27, 1986
**** Appointed May 20, 1986
***** Appointed October 23, 1986

Lower Churchill Development Corporation

Cyril J. Abery, Chairman
Charles Marriott, Vice-Chairman
David W. Mercer
Daniel E. Williams, Q.C.
Francis Fizzard

Power Distribution District of Newfoundland and Labrador

Cyril J. Abery, Chairman
T. David Collett, Vice-Chairman
Leo J. Cole, Member
R. Andrew Grant, Member
Garland W. Jennings, Member
David W. Mercer, Member

Gull Island Power Company Limited

Cyril J. Abery, Chairman
Leo J. Cole, Member
R. Andrew Grant, Member
John P. Henderson, Member
David W. Mercer, Member

OFFICERS

Newfoundland and Labrador Hydro

Cyril J. Abery, Chairman and
Chief Executive Officer
David W. Mercer, President
John P. Henderson, Executive Vice-President
Leo J. Cole, Vice-President,
Engineering and Construction
R. Andrew Grant, Vice-President,
Finance & Chief Financial Officer
Stewart Dicks, Vice-President,
Human Resources
T. David Collett, Vice-President,
Operations
Derek W. Osmond, Vice-President,
Rates and Corporate Services
Maureen P. Greene, Vice-President,
General Counsel and Corporate Secretary
Robert D.C. Taylor, Treasurer
John C. Roberts, Corporate Controller
Frank A. Wright, Assistant
Corporate Secretary
Gerald C. Bowers, Assistant Treasurer

Churchill Falls (Labrador) Corporation

Cyril J. Abery, Chairman and
Chief Executive Officer
John P. Henderson, President
David W. Reeves, Vice-President,
Operations and Engineering
R. Andrew Grant, Vice-President,
Finance and Chief Financial Officer
Maureen P. Greene, Vice-President,
General Counsel & Corporate Secretary
John C. Roberts, Corporate Controller
Robert D.C. Taylor, Treasurer
Frank A. Wright, Assistant Corporate Secretary
Gerald C. Bowers, Assistant Treasurer

Lower Churchill Development Corporation

Cyril J. Abery, Chairman
David W. Mercer, President
and Chief Executive Officer
Maureen P. Greene, Corporate Secretary
Charles Marriott, Vice-Chairman*

*Appointed March 19, 1986

Power Distribution District of Newfoundland and Labrador

Cyril J. Abery, Chairman
T. David Collett, Vice-Chairman
Maureen P. Greene, Corporate Secretary
Frank A. Wright, Assistant
Corporate Secretary

Gull Island Power Company

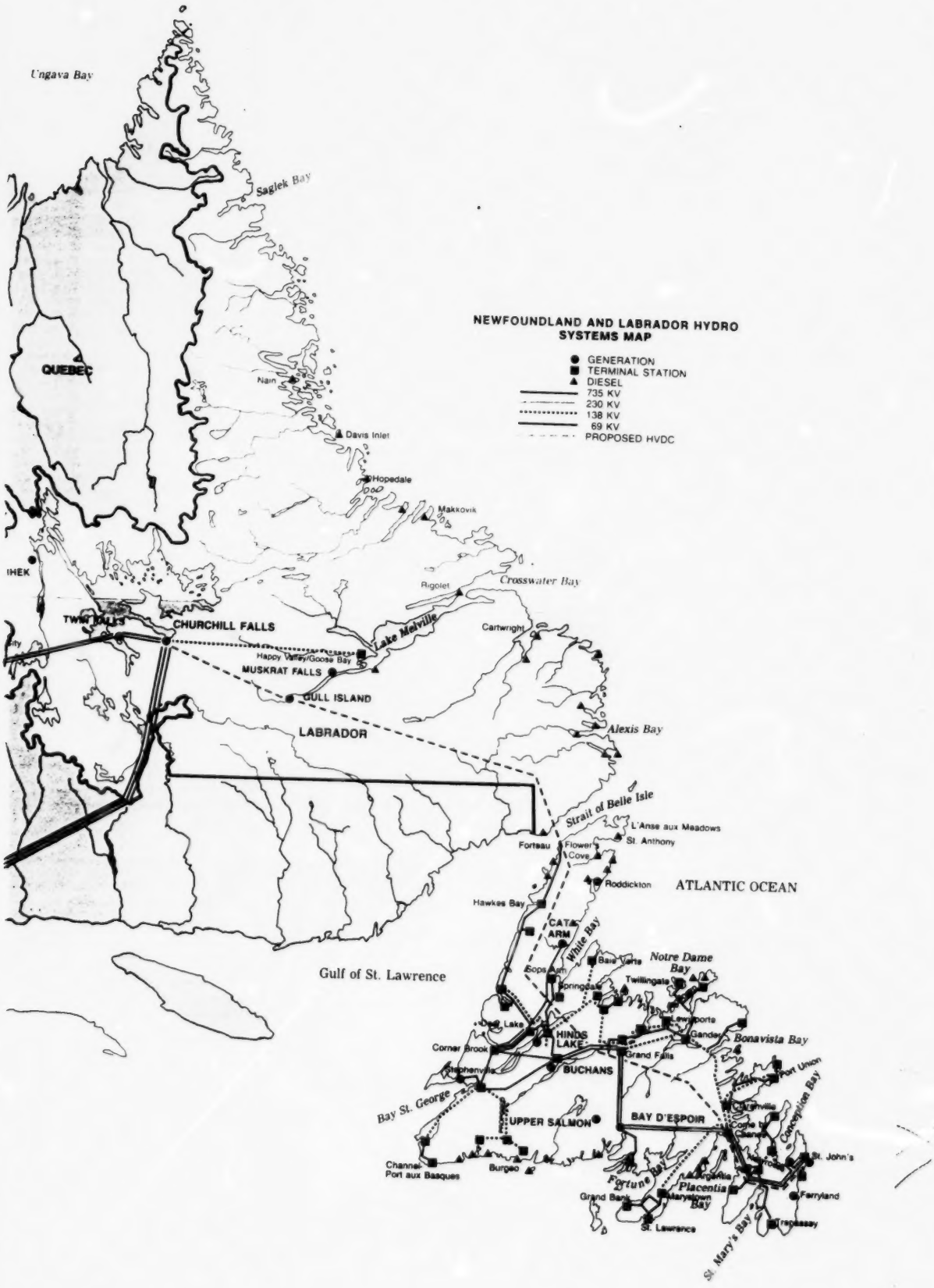
Cyril J. Abery, President and
Chief Executive Officer
John P. Henderson, Executive Vice-President
Leo J. Cole, Vice-President,
Engineering and Construction
David W. Mercer, Executive Vice-President
R. Andrew Grant, Vice-President, Finance
and Chief Financial Officer
Maureen P. Greene, Corporate Secretary
Robert D.C. Taylor, Treasurer
Frank A. Wright, Assistant Corporate Secretary

Newfoundland and Labrador Hydro
Head Office
50 Elizabeth Avenue
St. John's, Newfoundland A1A 2X8

Design and Production
Ted Mills

Photography
Gerry Boland

Printed by
Robinson-Blackmore Printing & Publishing


NEWFOUNDLAND AND LABRADOR HYDRO
SYSTEMS MAP
GENERATION
TERMINAL STATION
DIESEL
735 KV
230 KV
138 KV
69 KV
PROPOSED HVDC
Ungava Bay
Saglek Bay
QUEBEC
Nain
Davis Inlet
Hopedale
Makkovik
IHEK
Rigolet
Crosswater Bay
TWIN FALLS
CHURCHILL FALLS
Lake Melville
Cartwright
Happy Valley/Goose Bay
MUSKRAT FALLS
GULL ISLAND
LABRADOR
Alexis Bay
Strait of Belle Isle
L'Anse aux Meadows
Forteau
Flowers Cove
St. Anthony
Roddickton
ATLANTIC OCEAN
Hawkes Bay
CAT ARM
White Bay
Notre Dame Bay
Gulf of St. Lawrence
Springdale
Twillingate
Deer Lake
HINDS LAKE
Gander
Bonavista Bay
Corner Brook
Grand Falls
BUCHANS
Port Union
Bay St. George
UPPER SALMON
BAY D'ESPOIR
Conception Bay
St. John's
Channel-Port aux Basques
Burgeo
Fortune Bay
Placentia
Grand Bank
Marystown
Ferryland
St. Lawrence
Trepassey
St. Mary's Bay